

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0474

**Sales and Use Tax
For Tax Years 1995 through 1997**

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ISSUES

I. Sales Tax—Raw Material Delivery System

Authority: General Motors Corporation v. Indiana Department of Revenue, 578 N.E.2d 399 (Ind. Tax 1991); Indiana Department of Revenue v. Cave Stone, Inc. 457 N.E.2d 520 (Ind. App. 1983); IC 6-2.5-5-3; 45 IAC 2.2-5-8

Taxpayer protests the assessment of use tax on its purchase of a raw material delivery system.

II. Sales Tax—Packaging Materials

Authority: 45 IAC 2.2-5-16

Taxpayer protests the assessment of use tax on its purchase of packaging materials.

III. Tax Administration—Negligence Penalty

Authority: IC 6-8.1-10-2

Taxpayer protests the assessment of a ten percent (10%) penalty.

STATEMENT OF FACTS

Taxpayer is a plastic injection mold manufacturer. The products consist of plastic parts and components sold to other manufacturers for incorporation into their products. The Department of Revenue ("Department") conducted a tax audit for the years of 1995-1997. Taxpayer protested two of the items assessed, as well as a ten percent (10%) negligence penalty.

I. Sales and Use Tax—Raw material delivery system

DISCUSSION

Taxpayer protests assessment of use tax on equipment used to transport raw materials, plastic pellets, from storage to hoppers that feed injection molds. The auditor assessed the raw material delivery system as pre-production equipment. Taxpayer points to IC 6-2.5-5-3(b), which states:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Taxpayer explains that the system blends raw material by feeding the material into hoppers simultaneously. Taxpayer claims that the raw material delivery system is part of an integrated system, and therefore is essential and integral to the manufacturing process.

The Indiana Tax Court has decided that the equipment in question must be “essential and integrated” to the production process. General Motors Corporation v. Indiana Department of Revenue, 578 N.E.2d 399 (Ind. Tax 1991). In this instance, the raw materials are merely transported to the hoppers that feed the injection molds. The equipment in question only transports the raw material. All mixing takes place in the hoppers, after the raw material is delivered.

Taxpayer also raised 45 IAC 2.2-5-8(c)(2)(G) as applicable to this situation. That regulation states:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

Subsection (G) of 45 IAC 2.2-5-8(c)(2) provides an example of such equipment:

An automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry.

Taxpayer believes that its raw material delivery system is analogous to the automated scale process described above. The delivery system in question here does not measure quantities of raw material. It only moves raw material from storage to the hopper that feeds the injector.

Taxpayer also raises 45 IAC 2.2-5-8(g) to explain why the raw material delivery system should be exempt. Taxpayer refers to that portion of the regulation which states:

Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit.

Here, the raw material delivery system is not a component of a unit of machinery which has an immediate effect on the article being produced. It is a separate unit of machinery. The only function of that unit of machinery is to transport raw material from one point to another.

Taxpayer raises the language used by the Court in Cave Stone which warns of drawing the line of what constitutes “integral and essential” too narrowly, stating that, “To otherwise draw the line requires the mills of justice to grind too fine.” Indiana Department of State Revenue v. Cave Stone, Inc. 457 N.E.2d 520 (Ind. App. 1983). In the instant case, the equipment is not integral and essential to the production process. If the raw material delivery system did not transport the plastic pellets from storage to the hoppers, some other method would. While the alternate method might not be as efficient, the delivery would occur. Nothing happens to the pellets in the raw material delivery system to change them from pellets to something else or to mix them with another ingredient for the final product. Simple transportation from point A to point B, before any production has occurred, could be accomplished by many methods.

FINDING

Taxpayer’s protest is denied.

II. Sales Tax—Packaging Materials

DISCUSSION

Taxpayer protests assessment of sales tax on non-returnable packaging materials, such as spacers and pads inserted in boxes along with the product, it uses to ship its products to other manufacturers. Taxpayer cites 45 IAC 2.2-5-16(a) to support its position. 45 IAC 2.2-5-16(a) states:

The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents to be sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

The Department considers the items in question to be “enclosures”, as described in 45 IAC 2.2-5-16(a). Therefore, the items are exempt from the state gross retail tax.

FINDING

Taxpayer's protest is sustained.

III. Tax Administration—Negligence Penalty

DISCUSSION

Taxpayer protests imposition of a ten percent (10%) negligence penalty. Taxpayer claims that it has made good faith attempts to self-assess use tax and that it has provided reasonable arguments for its positions under protest. Taxpayer cites IC 6-8.1-10-2(d) in support of its position. That statute states:

If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on his return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

Taxpayer believes that imposition of the negligence penalty will not foster compliance, given its attempts to self-assess use tax. While the protest of the assessment on the packing materials was sustained, the Department's records show that taxpayer has been audited before and should have known the taxable status of the other items.

FINDING

Taxpayer's protest is denied.

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